



The Mechanics of School Debt Financing

CASBO/CDIAC ABCs of School Debt Financing

Sacramento – January 11, 2007

San Diego – January 18, 2007



Role of the Professionals

Robert J. Whalen
660 Newport Center Drive, Suite 1600
Newport Beach, CA 92660
(949) 725-4166

rwhalen@sycr.com

www.sycr.com





Role of the Professionals

Importance of Financing Team

Issuer Internal Team

Issuer Consultants

- ◆ **Financial Advisor**
- ◆ **Bond Counsel**
- ◆ **Disclosure Counsel**
- ◆ **Trustee**
- ◆ **Dissemination Agent**




Third Parties

- ◆ **County Treasurer/Auditor**
- ◆ **Underwriter**
- ◆ **Underwriter's Counsel**
- ◆ **Rating Agency**



OVERVIEW

IMPORTANCE OF FINANCING TEAM

-  **Optimal structuring to accomplish goals**
-  **Protection from potential legal liability**
-  **Better market acceptance of debt being sold**



PARTICIPANTS

ISSUER INTERNAL TEAM

- **General Counsel**
- **Finance Director**
- **Project Staff**
- **Risk Manager**



PARTICIPANTS



ISSUER CONSULTANTS

- **Financial Advisor**
- **Bond Counsel**
- **Disclosure Counsel**
- **Trustee**
- **Dissemination Agent**
- **Appraiser (Mello-Roos only)**
- **Market Absorption Consultant (Mello-Roos only)**

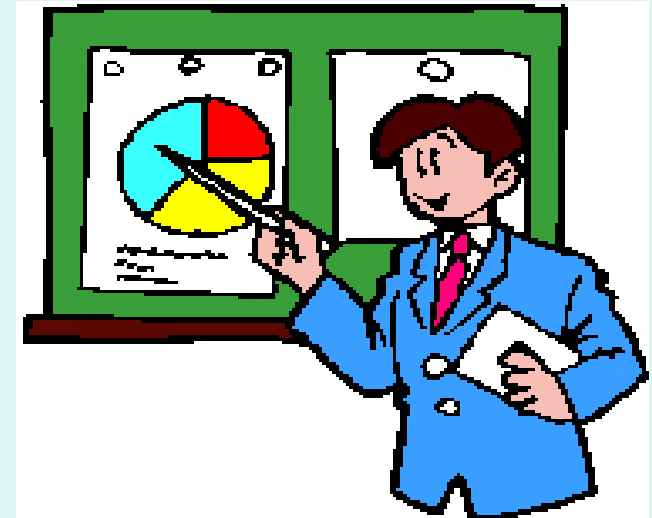


Financial Advisor

Financial Advisor: An independent consultant who advises the issuer on matters pertinent to the issue, such as structure, method of sale, timing, marketing, fairness of pricing, terms and bond ratings. Represents only the interests of the issuer.

Duties:

- Assist with debt authorization
- Explore Financing alternatives
- Construct financial model
- Assemble “Financing Team”
- Develop issuance timeline
- Evaluate and recommend method of sale
- Prepare bond specifications and terms
- Prepare district personnel and presentation materials for bond rating
- Manage bond sale
- Provide compliance



Financial Advisor



Bond Counsel

Bond Counsel:

An attorney who reviews/prepares the legal documents and writes an opinion on the authority to issue bonds, that legal requirements have been met, and the tax-exempt status of interest paid on the bonds.

Duties:

- **Issues valid obligation opinion**
- **Issues tax-exempt opinion**
- **Prepares legal documents including:**
 - **Resolution calling for election**
 - **Ballot proposition**
 - **Bond issuance resolution**
- **Advises:**
 - ☐ **State legal constraints**
 - ☐ **Federal tax law**
- **Prepares transcript of legal proceedings**



Bond Counsel



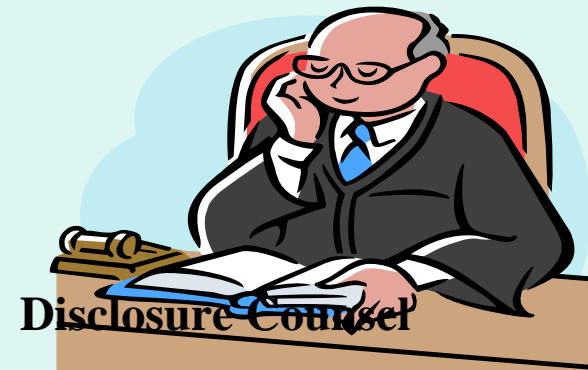
Disclosure Counsel

Disclosure Counsel:

A law firm retained to ensure that District has fairly disclosed all pertinent facts relating to the offering.

Duties:

- **Provide advice on disclosure obligations**
- **Prepare Official Statement**
- **Prepare Continuing Disclosure Agreement**





Bond Trustee/Registrar/Paying Agent

Bond Trustee: Usually a bank with trust power which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

Duties:

- Collects payments from Issuer
- ❑ Distributes payments to Investors



Bond Trustee/
Registrar/
Paying Agent

Registrar:

The person or entity responsible for maintaining records on behalf of the issuer for the purpose of notifying the owners of registered bonds. The paying agent frequently performs this function.

Duties:

- Invests Funds
- Disburses Funds

Paying Agent:

The entity responsible for the payment of interest and principal on municipal bonds on behalf of the issuer. The paying agent is usually a bank or trust company, but may be a county treasurer.



Dissemination Agent

Dissemination Agent:

The Dissemination Agent takes responsibility for filing the Annual Report under the Continuing Disclosure Agreement and filing notices of material events.

Duties:

- **Provides notice to Issuer if report not filed**
- **Files Annual Report**
- **Distributes material event notices**



Dissemination Agent



PARTICIPANTS



THIRD PARTIES

- **County Treasurer/Auditor**
- **Underwriter**
- **Underwriter's Counsel**
- **Rating Agencies**
- **Credit Enhancer**
- **Land Developer**



County Treasurer/Auditor

County Treasurer/Auditor:

The principal duties include the management and investment of County, Schools, and Special District funds, Bond Administration, and the collection of taxes and revenues.

Duties:

- **Holds proceeds of sale of bonds**
 - ❑ **Disburses funds upon Board authorization**
- **Invests bond proceeds**
- **Determines Tax Rates**
 - ❑ **Uses debt service information provided by Issuer (Official Statement)**
- **Prepares Tax Bill and collects taxes**
- **Sends money to Trustee/Paying Agent for payment of bonds**



**County
Treasurer/ Auditor**



Underwriter

Underwriter: Key function is to buy the new issue of securities from the issuer and resell the bonds to investors.

Duties:

- Offers to buy the bonds from the issuer at specific interest rates
 - ❑ Sells bonds to investors (institutional/retail)
 - ❑ Fee earned is called Underwriter's Spread (Reoffering Price – Purchase Price)
 - ❑ Can advise on structure/terms of financing (negotiated sale)
- Divisions:
 - ❑ Public Finance/Investment Banking
 - Liaison between underwriter and public officials
 - ❑ Underwriting/Trading
 - Prices bonds
 - Syndicate formation
 - Settlement/Clearing
 - ❑ Sales
 - Retail/Institutional





Underwriter's Counsel

Underwriter's Counsel: A law firm retained by the Underwriter to represent the Underwriter's interests.

Duties:

- Drafts Bond Purchase Agreement
- Reviews and comments on Official Statement
- Reviews and comments on Continuing Disclosure Agreement
- Prepares Blue Sky and Legal Investment Memoranda

Underwriter's Counsel





Rating Agency

Rating Agency: An independent service that provides a credit quality evaluation of bonds and notes. Standard & Poor's and Moody's are common for school district credit ratings.

Duties:

- Reviews four broad factors to determine rating:
 - The financial strength of the Issuer
 - The economic health of the community (commercial, industrial, residential)
 - Managerial and governance practices
 - Debt position – direct and overlapping debt, overall debt to wealth position
- Interviews Issuer, others
- Assigns a letter rating to bonds



Rating Agent



Schedule of Costs of Issuance

Service Provider	Amount
Underwriter	\$__ per \$1,000 of bonds
Bond Insurer	__% of total bond debt service
Financial Advisor	Fixed fee, per contract Plus reimbursable expenses
Bond Counsel	Fixed fee, per contract Plus reimbursable expenses
Disclosure Counsel	Fixed fee, per contract
Rating Agency	Per schedule, depending on principal amount of bonds
Paying Agent / Trustee	Fixed fee, per contract
Printer	Based on proposed fee, adjusted for actual # of copies and mailing costs.
Title Insurance	For COPs only





Description of Bond Ratings


Moody's	Standard & Poor's	Description
<u>High Grade</u>		
Aaa	AAA	The highest rating assigned to a debt instrument, indicating an extremely strong capacity to pay principal and interest. Bonds in this category are often referred to as “gilt-edge” securities.
Aa1	AA+	High-quality bonds by all standards with strong capacity to pay principal and interest and are judged to be of high quality by all standards. These bonds are rated lower primarily because the margins of protection are less strong than those for Aaa and AAA.
Aa2	AA	
Aa3	AA-	
<u>Medium Investment Grade</u>		
A1	A+	These bonds possess many favorable investment attributes, but elements that suggest a susceptibility to impairment given adverse economic changes may be present.
A2	A	
A3	A-	
Baa1	BBB+	Bonds are regarded as having adequate capacity to pay principal and interest, but certain protective elements may be lacking in the event of adverse economic conditions that could lead to a weakened capacity for payment.
Baa2	BBB	
Baa3	BBB-	
<u>Speculative</u>		
Ba1	BB+	Bonds regarded as having only moderate protection of principal and interest payments during both good and bad times.
Ba2	BB	
Ba3	BB-	
B1	B+	Bonds that generally lack characteristics of other desirable investments and have greater vulnerability to default. Assurance of interest and principal payments over any long period of time may be small.
B2	B	
B3	B-	



AB 1482 Requirements

-  AB 1482, also known as the Canciamilla Bill, went into affect on January 1, 2007.

-  Prior to the bond sale, the Board must adopt a resolution that:
 - Designates / approves method of sale;
 - States reasons for the method of sale selected;
 - Discloses the bond counsel, and the underwriter and financial advisor if either or both are used for the sale;
 - Estimates the costs associated with the issuance.

-  After the bonds sale, the actual costs associated with the issuance must be:
 - Presented to the Board;
 - Disclosed at the next scheduled public meeting;
 - Submitted to the California Debt and Investment Advisory Commission (CDIAC).



CDIAC/CASBO Workshop The ABC's of School Debt Financing

Competitive vs. Negotiated

Prepared By Ruth Alahydoian



KELLING, NORTHCROSS & NOBRIGA

A Division of Zions First National Bank

1333 Broadway, Suite 1000

Oakland, CA 94612

Phone: 510-839-8200

Fax: 510-208-8282

Web: www.knninc.com



Key Players in A Bond Sale



Underwriter intermediates between borrower and lender

- **Buys bonds at wholesale price from issuer**
- **Resells to investor at profit**
- **In negotiated sale, also serves as investment banker in assisting to structure transactions**

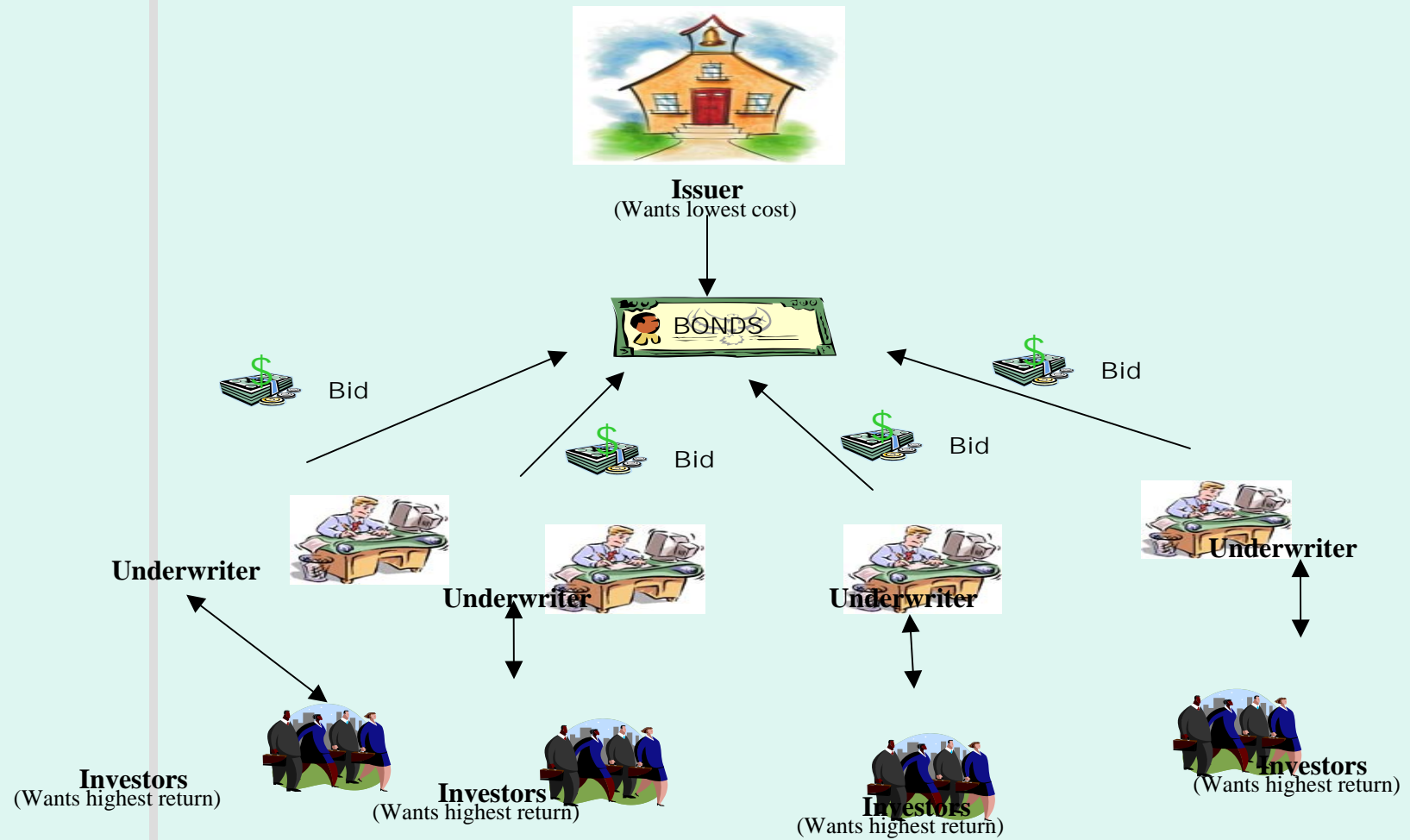


Competitive Sale

- Deal is structured by financial advisor
- Request for bids advertised
- Bids accepted at a specific date and time
 - Most commonly via electronic platform
- Bonds sold to bidder with lowest “true interest cost”
- Best when:
 - Market is familiar with issuer
 - Active secondary market, broad investor base
 - Unenhanced credit rating of “A” or above
 - Issue is neither too large nor too small
 - Not complex, easily understood revenue stream



Bond Sale - Competitive



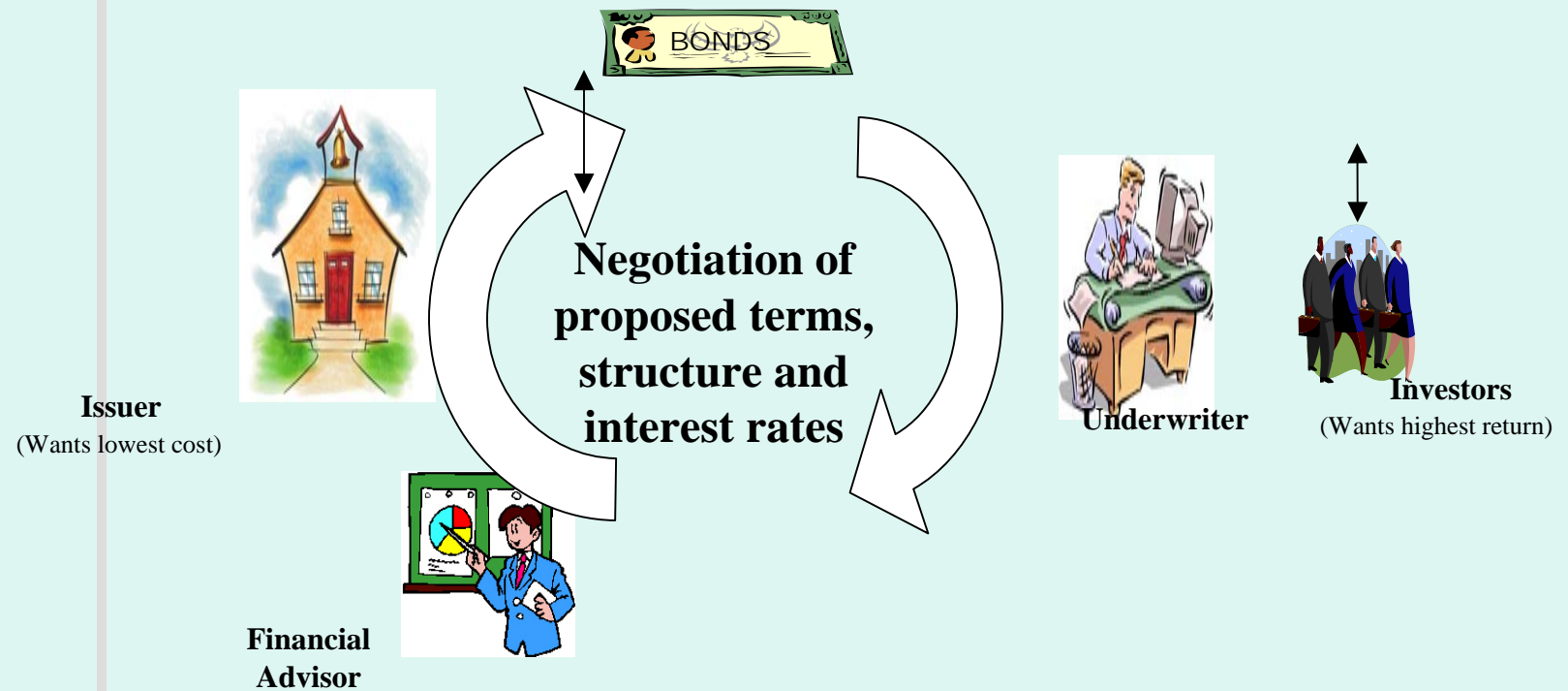


Negotiated Sale

- **Underwriter selected up-front**
- **Underwriter participates in structuring**
- **Interest rate established through collaboration**
- **Adjusted based on actual investor interest and orders**
 - **Individual maturities will be repriced based on order flow**
- **Best when:**
 - **Underwriter selection process ensures multiple proposals are considered**
 - **Knowledgeable employee or outside professional (other than underwriter) assist is structuring, pricing, and monitoring sales activities**



Bond Sale - Negotiated






Advantages of Each Method of Sale

Competitive Sale

-  Emphasizes “commodity” nature of bonds
-  Satisfies public policy preference for competitive procurement
-  Sometimes legally required
-  Generally the best way to get the lowest interest rate

Negotiated Sale

-  Best suited for “story bonds” and very large transactions
-  Allows underwriter to pre-market bonds
-  Transaction can be re-structured to meet specific investor demand
-  More flexibility in timing



COMPETITIVE vs. NEGOTIATED

Documents



BE A SMART CONSUMER

- ✦ **Take an active hand**
- ✦ **Make sure documents express your needs/desires**
- ✦ **Review and make needed changes**



Key Financing Documents

Robert J. Whalen
660 Newport Center Drive, Suite 1600
Newport Beach, CA 92660
(949) 725-4166

rwhalen@sycr.com

www.sycr.com





GENERAL OBLIGATION ELECTION DOCUMENTS



Decide 2/3 vs. 55% election



Resolution Calling Election

- **Date of Election**
- **Amount of authorization**
- **Bond project list**
- **Bond proposition**



Tax Rate Statement

- **Prepared by Financial Advisor**



Impartial Analysis

- **Prepared by Legal Counsel**



Resolution Certifying Results of Election



Resolution Appointing Citizens' Oversight Committee

- **Proposition 39 Elections only**
- **Within 60 days of Resolution Certifying Results**
- **Minimum 7 members**



GENERAL OBLIGATION ELECTION DOCUMENTS (cont'd)



Resolution Requesting County to Issue

- **Financing Parameters**
- **Approve Forms of Legal Documents**
- **AB 1482 Compliance**
 - **Method of Sale & Reasons**
 - **Disclosure of Consultants**
 - **Estimated Costs of Issuance**



Resolution of Issuance

- **Principal Amounts and Maturity Dates**
- **Interest Rates**
- **Redemption Provisions**
 - **Optional Call**
- **Amendment Procedures**
- **Investment Alternatives**



LEASE FINANCING DOCUMENTS

-  **Resolution of Issuance**
-  **Site Lease**
-  **Lease**
-  **Assignment Agreement**
-  **Indenture or Trust Agreement**
-  **Bond Purchase Contract or Notice of Sale**
-  **Official Statement (Preliminary and Final)**
-  **Continuing Disclosure Agreement or Certificate**
-  **Credit Enhancement Documents**
-  **Closing Certificates and Opinions**
-  **Refunding Escrow Agreement**
 - **Verification Report**
 - **Defeasance Opinion**



LEASE FINANCING DOCUMENTS (cont'd)



RESOLUTION OF ISSUANCE

- **Not to Exceed Amount**
- **Authorized Officers**
- **Parameters of Sale**
 - **Interest Rate or Savings**
 - **Underwriter's Discount**
 - **Credit Enhancement**
- **Compliance with or Waivers of Debt Policies**
- **CEQA Compliance**



LEASE FINANCING DOCUMENTS (cont'd)

LEASE

- **Asset Transfer vs. Project Based**
 - **Capitalized Interest**
 - **Substitution and Release Rights**
- **Lease Payments**
 - **Interest and Principal Components**
 - **Variable or Fixed**
 - **Frequency**
- **Abatement**
 - **Payments only if beneficial use and occupancy**
 - **Completion risk**
 - **Loss of use**



LEASE FINANCING DOCUMENTS (cont'd)

LEASE

➤ **Insurance**

➤ **Types (liability, hazard, title, rental interruption, worker's compensation)**

➤ **Limits and Deductibles**

➤ **Self-Insurance**

➤ **No for rental interruption**

➤ **Adequacy of reserves**

➤ **Credit Enhancer approval**



LEASE FINANCING DOCUMENTS (cont'd)



LEASE

- **Prepayment**
 - **Ties to Trust Agreement**
- **Remedies**
 - **Re-enter and re-let**
 - **Terminate or Continue**
 - **Damages**
- **Tax Covenants**
- **Restrictions on Use of Facility**



LEASE FINANCING DOCUMENTS (cont'd)



ASSIGNMENT AGREEMENT

- **Assign rights under Lease to Trustee**



TRUST AGREEMENT

- **Lease Revenue Bonds vs. Certificates of Participation**
- **Denominations and Interest Payment Dates**
- **Project Fund Requisition Process**
- **Prepayment or Redemption Terms**
 - **Optional**
 - **Extraordinary**
 - **Sinking Fund**



LEASE FINANCING DOCUMENTS (cont'd)



TRUST AGREEMENT

- **Additional Certificates/Bonds (Parity Test)**
- **Security Covenants**
 - **Payment covenant**
 - **Defend against legal actions**
 - **Compliance with terms of lease**
 - **Tax covenants**
- **Investment of Funds**
 - **Permitted Investments**
 - **Who directs**



LEASE FINANCING DOCUMENTS (cont'd)



TRUST AGREEMENT

- ◆ **Amendment Process**
 - ◆ **With Bondowners' Consent**
 - ◆ **Without Bondowners' Consent**
- ◆ **Remedies**
 - ◆ **Events of Default**
 - ◆ **Credit Enhancer Control**
- ◆ **Defeasance**
 - ◆ **Permitted security**
 - ◆ **Defeasance opinion**
 - ◆ **Verification Report**



MELLO-ROOS FORMATION



Key Building Blocks

- **Project list**
- **Joint Community Facilities Agreements**
- **Rate and Method of Apportionment of Special Tax**
- **District Map**



Petition from Property Owner or Board Initiated



Resolutions of Intention

- **To Form District**
- **To Incur Debt**



Public Report



Public Hearing

- **At least 30 days after Resolution of Formation**



MELLO-ROOS FORMATION (cont'd)



Resolutions of Formation

- **Form District**
- **Incur Debt**
- **Call Election**



Election

- **Two-Thirds Vote Required**



Resolution Certifying Results



Ordinance Authorizing Levy



Record Notice of Special Tax Lien



Disclosure

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DISCLOSURE DUE DILIGENCE



Federal Securities Laws

- ◆ **Section 17(a) of 1933 Act – Antifraud Provisions**
- ◆ **Rule 10b-5**



Duty - Disclose all material facts (i.e., facts that are important to an investor in making an informed investment decision) and do not misstate any material facts



DISCLOSURE DUE DILIGENCE (cont'd)



Role of Staff:

- **Provide information to consultants**
- **Review drafts of Preliminary Official Statement**
- **Notify Board members of duty to review and disclose**
- **Schedule conference call to review draft of Preliminary Official Statement**
- **Distribute final version of Preliminary Official Statement to Board for review**



DISCLOSURE DUE DILIGENCE (cont'd)






Role of Board:

- **Oversight**
- **Review draft Preliminary Official Statement**
- **Ask questions of staff and consultants**
- **Approve distribution of Preliminary Official Statement**



QUESTIONS FOR BOARD TO ASK

-  **Am I aware of any information about the District that would be important for an investor to know?**
-  **Is there any pending or threatened litigation against the District that could have a negative impact on the District's finances or ability to repay the debt?**
-  **Are there any circumstances that exist or that are now unfolding that could place a demand on District reserves or create budget difficulties for the District?**



OFFICIAL STATEMENT



OFFICIAL STATEMENT

- **Preliminary vs. Final**
 - **Preliminary used to market certificates/bonds to potential investors**
 - **Final delivered to actual purchasers**
- **Issuer's Document**
- **Guidance**
 - **Federal Securities Law (Rule 15c2-12 and 10b-5)**
 - **Professional Guidelines (CDIAC, GFOA)**



OFFICIAL STATEMENT (cont'd)



OFFICIAL STATEMENT

- **Purpose to describe the debt, issuer and sources of repayment**
- **Disclose All Material Facts**
 - **Rule 10b-5 Anti-fraud provisions**
 - **Do not omit or misstate a material fact**
- **What is Material?**
 - **Important facts to an investor in making a decision**



OFFICIAL STATEMENT (cont'd)



OFFICIAL STATEMENT

- **Who Prepares?**
 - **Disclosure Counsel**
 - **Underwriter's Counsel**
- **Who Reviews?**
 - **Staff**
 - **Public Officials**
 - **Actual Knowledge**
 - **Reckless Disregard**



OFFICIAL STATEMENT (cont'd)



OFFICIAL STATEMENT

- **Liability**
 - **Issuer strictly liable**
 - **Underwriter**
 - **“Due diligence” defense - reasonable investigation**
- **Rule 15c2-12**
 - **Deemed Final Preliminary Official Statement**
 - **Permitted Omissions of Pricing Data**



OFFICIAL STATEMENT (cont'd)



OFFICIAL STATEMENT

➤ Contents

- Description of Certificates or Bonds
- Security and Sources of Payment
- Estimated Sources and Uses
- The Leased Premises
- The Project
- The Issuer (General Description and Financial Matters)
- Risk Factors
- Continuing Disclosure



OFFICIAL STATEMENT (cont'd)



OFFICIAL STATEMENT

➤ Contents (cont'd)

➤ Concluding Information

- Tax Matters
- Ratings
- Litigation
- Financial Interests

➤ Appendices

- Economic and Statistical Data re Issuer
- Audited Financials
- Form of Bond Counsel Opinion
- Summary of Legal Documents
- Credit Enhancement



BOND SALE DOCUMENTS



COMPETITIVE VS. NEGOTIATED

- **Notice of Sale invites public bids**
- **Bond Purchase Contract with selected underwriter**



BOND PURCHASE CONTRACT

- **Establishes Bond/COP Terms**
 - **Principal amounts and maturity dates**
 - **Interest rates**
- **Underwriter's Discount**



BOND SALE DOCUMENTS (cont'd)



BOND PURCHASE CONTRACT

- **Representations and Warranties**
 - **Due authorization**
 - **No conflict**
 - **No litigation**
 - **No prior continuing disclosure default**
 - **Duty to update Official Statement (25 vs. 90 days)**
- **Termination Provisions**
 - **“War out”**
 - **Other market disruptions**



BOND SALE DOCUMENTS (cont'd)



BOND PURCHASE CONTRACT

- **Responsibility for Expenses**
- **Closing Documents and Opinions**
- **Liquidated Damages**
 - **Good faith check**
- **Indemnification Provisions**



CONTINUING DISCLOSURE DOCUMENTS



CONTINUING DISCLOSURE AGREEMENT/CERTIFICATE

- ◆ **Key Issues**
 - ◆ **Who prepares and files**
 - ◆ **Deadline for filing**
 - ◆ **Provisions for noncompliance**
- ◆ **Dissemination Agent**
- ◆ **Obligated Persons (Conduit Borrowings)**
- ◆ **Reporting Date**
- ◆ **NRMSIRS (Nationally Recognized Municipal Securities
Information Reporting)**



CONTINUING DISCLOSURE DOCUMENTS (cont'd)



CONTINUING DISCLOSURE AGREEMENT/CERTIFICATE

- **Contents of Annual Report**
 - **Audit**
 - **Updated financial information**
- **Material Event Disclosure**
 - **11 events mandatory**
 - **Special events discretionary**
- **Termination**
 - **Payoff or defeasance of obligations**



CREDIT ENHANCEMENT DOCUMENTS



CREDIT ENHANCEMENT AGREEMENTS

- **Bond Insurance**
 - **Commitment Letter**
 - **Bond Insurance Policy**
 - **Standard Terms and Conditions**
 - **Closing Opinions and Certifications**



CREDIT ENHANCEMENT DOCUMENTS (cont'd)



CREDIT ENHANCEMENT AGREEMENTS

- **Letters of Credit**
- **Reimbursement Agreement**
- **Closing Certificates and Opinions**
- **Liquidity Facilities**



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Ratings

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Ratings



Purpose of Ratings:

- **To help investors assess the issuer's ability to repay the bonds**
- **Provide independent, trusted, consistent and comparable information/evaluation**
- **Allows comparison among credits**



NOT a substitute for full disclosure by the Issuer, or due diligence by the investor



Getting the Grade



Ratings provide:

- ➔ Differentiation of credit quality
- ➔ Credit risk evaluation



Ratings are further differentiated within each grade – Moody's uses 1-2-3, S&P and Fitch use +/-

Credit Risk	Moody's	Standard & Poor's	Fitch
<i>Investment Grade:</i>			
Highest Quality	Aaa	AAA	AAA
High Quality (Very Strong)	Aa	AA	AA
Upper Medium Grade	A	A	A
Medium Grade	Baa	BBB	BBB
<i>Non-Investment Grade:</i>			
Somewhat Speculative	Ba	BB	BB
Speculative	B	BB	B
Highly Speculative	Caa	CCC	CCC
Most Speculative	Ca	CC	CC
Imminent Default	C	D	C
Default	C	D	D



What are they looking for?

ABILITY TO REPAY

Repayment source:

- **GOBs – Taxbase, economics of region**
- **COPs – Identified source? GF of District?**
- **TRANS – Tax revenues, coverage**

Debt Structure:

- **Legally sound**
- **Reasonable repayment structure**

Other Debt:

- **Debt ratios**
- **Other “overlapping” debt**



Differentiating among similar credits



District Finances

- **Flexibility – class sizes, other funds**
- **Fund Balances**
- **Budget management**



Projects to be Financed

- **Essentiality**
- **Ability to complete projects**



District management

- **Community relations**
- **Labor relations**
- **Stability & Experience of Administration, Board**



Credit Review Process

Credit Strategy

Historical Ratings

Which rating agencies

Underlying Ratings

Will you seek credit enhancement

Credit Profile/Story

Credit Presentation

The Road Show or Tour
(Show/See & Tell)

Credit Strengths

The Presentation Team

The Presentation Book

Credit Result

Negotiating for the best possible rating

The legal structure –where are you flexible and where can you give

Getting your rating

Do you like it and want to use it

What lessons have you learned